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1 A Well, it's got to be placed in context.
2 It's -- it's complex relative to alternatives,
3 particularly alternatives that would be more consistent
4 with this Commission's movement toward expanding the
5 sphere of competition.

6 It's not too complex in some absolute
7 unworkability sense, but it is more complex than would
8 be a system consistent with a world in which competition
9 plays a larger role.

10 Q Now, wouldn't it also be fair to say that the
11 price cap mechanism could be more complex than it is
12 currently?

13 A Of course, one can measure Baroque variations
14 in tangency.

15 Q Is it your testimony that the price cap
16 mechanism is unpredictable?

17 A I think the issue of predictability here
18 really arises on a couple of fronts. One front is, of
19 course, all these proceedings that everyone is going
20 through. It means the structure will change in ways
21 that we don't now see.

22 There are also predictability issues referred
23 earlier today, but we'll undoubtedly hear, as before,
24 debates of the proper X. In that sense, there is a good
25 deal of uncertainty about how the regulatory process
26 will decide an X factor.

27 There is an unpredictable -- an element of
28 unpredictability.

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1 Q But, Dr. Smalensee, under Pacific Bell's
2 proposal, where Pacific Bell would be placing the
3 decision about the rates for Category 1 services purely
4 within the hands of the Commission, it would engender
5 exactly that same type of unpredictability, would it
6 not?

7 A Taken in isolation and taken apart from the
8 context, which is what you reminded me has to do with
9 these other proceedings, it would have that effect.

10 In context, I think one has to view this as
11 one piece, and maybe one intermediate step toward a
12 regime in which regulation would be more predictable.

13 Q Now, isn't it true that in your testimony
14 where you talk about the operation of the current price
15 cap framework, one of the issues you take with that
16 mechanism is the fact that there are certain things that
17 happen automatically. For instance, the automatic
18 decreases in the price ceilings where the price index
19 exceeds -- is exceeded by the inflation rate.

20 A I don't take issue with the fact that the
21 price cap change is effective automatically. That is a
22 mechanism of price cap systems.

23 What the testimony at least tried to point to
24 was the special characteristic here that all prices move
25 in lock step. They are basic characteristics. There
26 are, in fact, individual prices moved up and down --
27 which is an unusual feature -- which results in prices
28 that are already below cost being driven mechanically

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1 further below cost.

2 Q Yeah. I appreciate that that's the nature of
3 the testimony you've given.

4 What I'm asking you -- and I would like to
5 restate my question because after concluding it I
6 realize there was a twist in terminology there -- isn't
7 it true that you take issue with what is a very
8 predictable component of the price cap formula whereby
9 price ceilings by regulated services are automatically
10 decreased where the inflation rate is exceeded by the
11 productivity factor?

12 A Well, I'm sorry; I tried to be clear in my
13 answer what I took issue with. I don't take issue with
14 that aspect of a price cap. I think there are better
15 ways to go. But that is a characteristic of price cap
16 regimes, and it's not that to which I object.

17 Q So you would agree then that the price cap
18 formula is predictable.

19 A Given that an X has been determined, the
20 operation of a price cap is predictable, that's
21 correct. But the determination of the X is, of course,
22 another matter.

23 Q Now, is it your opinion that the current price
24 cap mechanism is grounded on unsound economic
25 principles?

26 A Well, in certain respects, yes, as the
27 testimony sought to describe. It can be improved in a
28 number of respects, which I describe in the body of the

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1 testimony.

2 Q Let me direct your attention to page 1 of
3 Attachment 1 to your direct testimony.

4 In the middle of the second full paragraph,
5 approximately the fourth line down, is a sentence that
6 begins:

7 "First, the proposal would let the
8 marketplace, rather than regulation,
9 work for services for which
10 competition will provide price
11 protection and other benefits such
12 as increased innovation."

13 Do you see that?

14 A Yes, I do.

15 Q Now, is it your opinion that the marketplace
16 alone would provide adequate protection, for instance,
17 for Category 2 or partially competitive services?

18 A Not at least -- assuming that the -- sorry;
19 let me step back.

20 If, by that, you mean services that are
21 properly categorized as partially competitive, no, I
22 don't believe that full deregulation in that case is
23 appropriate; that some degree of Commission oversight
24 would continue to be appropriate for services which
25 competition doesn't work effectively, not necessarily
26 price-by-price control, of course.

27 Q Further down in that paragraph where the
28 sentence begins:

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1 asked for and received a copy of the decision which
2 that's -- language to that effect appears.

3 I believe the initial conversation was
4 probably with Mr. McCarthy, but I also believe, as I
5 say, that I've seen excerpts from the decision -- a
6 decision addressing that question.

7 Q When you talk about the decision addressing
8 that question, are you referring to the IRD Decision
9 that affected the rate rebalancing between intraLATA
10 toll and basic service?

11 A As I sit here, I'm not certain.

12 Q Would you agree that in a fully-competitive
13 market, competition will act to drive prices lower?

14 A I don't understand that question; lower than
15 what?

16 Q All right; that's a good answer.

17 Would you agree that in a fully competitive
18 market, competition will act to keep prices low?

19 A Fully-competitive market competition tends to
20 drive out excess profit, tends to provide incentives for
21 productive efficiency and tends to keep prices in line
22 with cost.]

23 Q Is it your understanding that the price-cap
24 formula was designed to create an incentive for the LECs
25 to operate more efficiently and to keep costs low?

26 A Yes.

27 Q Is it your understanding that the price-cap
28 formula was designed to create an incentive for the LECs

1 to be able to reduce their rates and still earn a
2 reasonable return on their investment?

3 A Again, not having powers of telepathy nor
4 having reviewed all the language in the decisions that
5 laid out that formula, it's certainly consistent with my
6 understanding that that was the Commission's intention
7 at the time.

8 Q So isn't it also true that even under a
9 price-cap formula, that with increases in efficiency,
10 coupled with lower prices, that the LECs could be better
11 able to compete against new entrants than they were
12 under prior regulatory regimes?

13 A There are at least two separate issues raised
14 by that question: To the extent that price caps
15 provide -- provided historically increased incentives
16 for efficiency, then -- and that the LECs responded
17 appropriately to those incentives, they have lower costs
18 than they otherwise would and are therefore better
19 positioned to face competition, that's right.

20 To the extent, however, that, in order to
21 compete effectively, one must have the same or similar
22 pricing flexibility to the flexibility enjoyed by
23 competitors -- there the difference between a
24 rate-of-return regulation and this particular flavor of
25 price caps is less dramatic, and so it's not clear that
26 there is an enhanced freedom to take the marketplace
27 actions necessary to compete effectively.

28 Q Now, specifically with regard to the second

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1 part of your answer where you spoke of pricing
2 flexibility in response to competitive entry or the
3 offers of competitors, let me direct your attention to
4 page 3 of your testimony, the Attachment 1 to your
5 direct testimony.

6 Specifically, the second full paragraph, on
7 line 3, is a sentence that begins:

8 "Just as the extent of
9 competition defines a continuum from
10 monopoly supply to open
11 competition"

12 Specifically, I want to focus your attention
13 on that "continuum from monopoly supply to open
14 competition."

15 Would you agree that one does not move from
16 one end of the continuum, for instance, monopoly supply,
17 to the other end of the continuum, open competition,
18 overnight?

19 A I don't know if there is a general statement
20 that applies. You can.

21 If regulation has been holding back a
22 floodgate -- has been serving as a floodgate holding
23 back lots of eager competitors, then the movement can
24 happen rather quickly.

25 I think, for instance -- well, obviously,
26 intraLATA toll here provides an interesting case study
27 of a rather quick competitive response, but even
28 thinking of airline markets where regulation made some

1 markets monopolies, they became effectively competitive
2 rather quickly because of freedom of entry after
3 deregulation.

4 So it can happen fast. Very few things in
5 this world happen instantaneously, but it can happen
6 fast.

7 Q Now, is it your opinion that the only barrier
8 to entry in the local exchange markets is the fact that
9 regulation has been holding back the floodgate?

10 A I haven't done a detailed study of those
11 markets.

12 It's my understanding that, just as in many
13 other markets that we think of as effectively
14 competitive, there are obstacles that might make it
15 difficult for me to go out and enter.

16 But I haven't seen anything that suggests that
17 those obstacles are such as to prevent effective
18 competition.

19 Q Now, a moment ago you said you have not seen
20 any obstacles that would appear to you to prohibit
21 effective competition; is that accurate?

22 A That's accurate.

23 Q But yet you haven't done a detailed study of
24 the LEC markets?

25 A I have not done a detailed study of the --
26 these particular markets, no.

27 Q Now, further down in that same paragraph, the
28 sentence beginning approximately on line 6:

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1 "That is, in order for such
2 competition to benefit California's
3 consumers, the regulatory regime
4 must be compatible with the state of
5 competition."

6 Do you see that?

7 A Yes.

8 Q Wouldn't you agree, based on that statement,
9 that as competition evolves across this continuum from
10 monopoly supply to open competition, that the regulation
11 must also evolve?

12 A Well, there's a -- there are a set of
13 reasonably complicated policy questions there.

14 I think questions have arisen in this industry
15 that arises in others is whether you modify regulation
16 in circumstances when you can reasonably expect
17 competition to appear or whether you leave a regime
18 inappropriate for competition in place, remove
19 regulatory barriers, see what happens, and then react.

20 I've said in a number of contexts, I tend to
21 favor the first approach.

22 Because under the second approach you have a
23 regime of distorted investment incentives and a set of
24 incentives to stop the evolution of the regulatory
25 system.

26 So I guess if in your question was the notion
27 that one waits and then reacts, I tend to think that's,
28 in most settings I've looked at, inefficient.

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1 Q So would it be fair to say that a compromise
2 between those two alternatives -- the first one being
3 where, for instance, this Commission might take no
4 action whatsoever, wait to see if competition evolves
5 and then react, when contrasted with the other, which is
6 completely remove all regulation of the LECs in
7 anticipation that competition will develop -- your
8 opinion is that something in between is probably a more
9 appropriate economically sound response?

10 A I think in between, but also something that
11 provides for a relatively predictable path of regulatory
12 change.

13 I think the difficulty is in designing a
14 transition path that is -- one -- wants a path that gets
15 predictably to full deregulation, that allows for the
16 emergence of competition, that isn't easily gained, and
17 that usually, I think, inclines, I think particularly of
18 some things that Fred Kahn's written on his airline
19 experience, which are very much on point in other
20 settings, that if you try to fine-tune the deregulation
21 path, you go too slowly; that the better error is on the
22 other side.

23 Q Let me direct your attention to page 4 of
24 Attachment 1 to your direct testimony,, particularly the
25 first full paragraph about halfway down, talking about:

26 "In this spirit, we
27 respectfully submit that major
28 changes to the framework must be

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1 made to respond to a world in which
2 market forces will replace
3 regulation as the primary
4 determinant of how
5 telecommunications services are
6 provided."

7 When do you anticipate that market forces are
8 going to replace regulation as the primary determinant
9 of how telecommunications services are provided in the
10 State of California?

11 A I can't put a precise date -- I can't put a
12 date on that with -- with any reliability, and I don't
13 think anybody can.

14 I think the issue here is being consistent
15 with a movement in that direction.

16 It's, obviously, important from a policy point
17 of view to retain key safeguards. But it's also
18 important to make -- put in place a system that's
19 consistent with that movement.

20 Q Now, speaking of those key safeguards, in your
21 testimony, is it your -- is it your testimony that
22 Commission approval of Category I price changes is one
23 such key safeguard under Pacific's proposal?

24 A Yes.

25 Q Wasn't one of the primary goals of the
26 price-cap mechanism to allow the LEC pricing flexibility
27 between the established floor and ceiling?

28 A Not in Category I as I understand it.

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1 In Category I the LEC has no pricing
2 flexibility.

3 Q With regard to Category II.

4 A With regard to Category II there is
5 flexibility, yes.

6 Q And certainly with regard to Category III.

7 A Of course, that -- that flexibility would be
8 retained under the -- this proposal as regards
9 Categories II and III.

10 Q Now, on page 5 of the attachment to your
11 direct testimony, second sentence, in the first full
12 paragraph, where you're referring to "vigorous and
13 growing competition," you're referring to the intraLATA
14 toll market; is that accurate?

15 A Yes. Although there's also a suggestion that,
16 obviously, the opening of local exchange competition
17 will also further expand the scope. But the primary
18 reference is to intraLATA toll.

19 Q So you're anticipating that there's going to
20 be vigorous and growing competition in the local
21 exchange markets; is that accurate?

22 A I'm anticipating that there will be more
23 competition. "Vigorous and growing" is intended to
24 apply to the whole landscape, not just to local
25 exchange.

26 Q Now, earlier, when we were talking about the
27 evolution of competition in the local exchange markets,
28 you mentioned that competition could enter very fast

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1 under circumstances where regulation was holding back
2 the floodgate; isn't that true?

3 A It sounds like a good rendition, yes.

4 Q In that case, we're talking about a legal
5 barrier to entry; are we not?

6 A In that case, yes.

7 Q Isn't it true that there are also significant
8 economic barriers to entry in local exchange?

9 A There's a range of opinion, particularly in
10 light of a wireless technology, just how significant
11 those barriers are.

12 And in -- in terms of what we've seen, in
13 terms of high density business traffic, it's not obvious
14 that the entry barriers in competing for business
15 traffic are huge; and in competing for residential and
16 small business traffic, the advent of new wireless
17 technologies and of cable telephony I think suggest that
18 the barriers may be a lot less than they used to be.

19 I haven't done a quantitative study, but it
20 seems clear just from trade press that the rate of --
21 the direction and rate of change are clear.

22 Q Now, when you talk about wireless technology,
23 isn't it true that to provide wireless services you have
24 to have a license from the FCC?

25 A That is consistent with my understanding, yes.

26 Q And isn't that also a legal barrier to entry?

27 A Well, except that the FCC has auctioned off
28 for -- and for cellular granted, but for PCS auctioned

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1 off -- a set of licenses so that there is a restriction,
2 but the restriction is not to monopoly levels. It's to
3 levels consistent with competition.

4 Q And do you -- have you done any study as to
5 what prices were paid for those licenses that were
6 auctioned off?

7 A I have not studied those prices, no.

8 Q So a moment ago when you testified that one
9 could get involved in wireless technology and
10 significantly undercut the economic barriers to entry,
11 you weren't thinking of PCS, were you?

12 A I don't think I used that language.

13 I said I think that the advent of wireless
14 technology reduced the barriers to entry.

15 And I think I stand by that, and I was
16 thinking of PCS.

17 Q So the -- the amounts -- you were taking into
18 account the -- the amounts that were paid for the PCS
19 licenses as being significantly lower economic barrier
20 to entry than what it would take, for instance, to be a
21 facilities-based carrier?

22 A That was certainly my understanding when some
23 time ago I looked at the numbers.

24 I didn't run -- I didn't ever systematically
25 compare them with the cost of putting in wire-based
26 facilities. But that was certainly the impression I
27 formed at the time.

28 Q Now, a moment ago when you talked about cable

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1 telephony, are you talking about the provision of
2 telephone services over cable, wireline networks?

3 A I was talking about that, yeah. As I -- it
4 was just an example of another new technology.

5 Q And is it your opinion that there's a
6 relatively small economic barrier to entry if you want
7 to become a cable-telephony facilities-based carrier?

8 A I think with current technology, at the moment
9 that barrier would not be well described as
10 insignificant.

11 I think it's a reasonable -- reasonable amount
12 of money, on the order of hundreds of dollars per, let's
13 say, household. I was operating on the expectation that
14 I think, again, certainly suffuses the trade press and
15 discussion of this industry that, A, those costs will
16 fall and, B, that, other services will be bundled with
17 telephony in such a way that those costs won't be
18 incurred just to enter telephony.]

19 Q At the bottom of page 5 where you are talking
20 about the eight regulatory goals of the NRF framework,
21 incentive regulation, specifically you say:

22 "Accordingly, although these goals
23 remain valid in today's competitive
24 environment...."

25 Which competitive environment were you
26 referring to there?

27 A Well, that may be a little bit of a rhetorical
28 tense shift. I think the competitive environment

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1 anticipated today might be a better way of rendering
2 it.

3 Obviously, there is more competition today
4 than there was when those regulatory goals were put in
5 place and more competition going forward than was
6 anticipated then.

7 But this is intended I hope plainly to take
8 account of the fact that California is in process, so to
9 speak, in moving toward competition.

10 Q The second full sentence on page 6 where that
11 last sentence lobbed over, you say:

12 "Regulation will no longer be
13 completely able to determine the
14 prices of services, nor target
15 particular price reductions to
16 specific customer types."

17 Do you see that?

18 A Yes.

19 Q Yet, Pacific continues to propose that
20 regulation will in fact completely determine the prices
21 of Cat 1 services, isn't that true?

22 A That is the probably here in this aspect of
23 the various proceedings, yes. It is my understanding
24 they have also sought pricing flexibility and in the
25 local universal service proceeding have dealt with this,
26 but that's beyond my scope.

27 Q Has Pacific, has anyone at Pacific discussed
28 with you if Pacific intends to approach this Commission

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1 regarding completely removing regulatory oversight of
2 Cat 1 services?

3 A I have heard no such suggestion, no.

4 Q Now, at the beginning of the next paragraph in
5 your testimony, we get back to that continuum between
6 monopoly and free market entry. Specifically the second
7 sentence that begins on line 2 of page 6, says:

8 "In order to effect economically
9 efficient outcomes along this
10 continuum, any required regulation
11 must be tailored to the competitive
12 conditions at hand and must adapt to
13 likely near-term changes in those
14 conditions."

15 Do you see that?

16 A Yes.

17 Q Is it your understanding that under the IRD
18 decision the Commission established a timeline whereby
19 it will reconsider the NRF framework every three years
20 or so?

21 A That's consistent with my understanding,
22 although there is a timeline for reconsideration, but
23 exactly what it is and where it was established I don't
24 claim familiarity.

25 Q Now, is it your opinion that if the Commission
26 were to reevaluate and adjust the NRF framework, say,
27 every three years, that it would not be adapting to
28 near-term changes in competitive conditions in the local

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1 exchange market?

2 A Well, I think given the decision to open up
3 intraLATA toll and to open up local exchange, that it
4 makes sense in that context to look at the regulatory
5 framework.

6 Whether as an abstract -- certainly as an
7 abstract matter, if there were no changes, no major
8 changes in competition, three years is a reasonable
9 timing for review. But when major changes in the
10 competitive environment are in the offing, it seems to
11 me review makes sense then.

12 Going forward, I would hesitate to pick a
13 period.

14 Q In talking about major changes in the market
15 conditions, would you consider the introduction of
16 competition in the intraLATA toll market to be a major
17 change in the competitive conditions in that market?

18 A Yes.

19 Q So within a year of doing that, the Commission
20 is now looking at the new regulatory framework in light
21 of those changes, is it not?

22 A I guess that's my understanding, yes.

23 Q And we have introduction of competition into
24 the local exchange market imminent, '96, isn't that
25 true?

26 A Yes.

27 Q But as you sit here today, you will not
28 predict whether the Commission revisiting this issue in

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1 three years is an adequate response to that change in
2 condition?

3 A Because it is not clear to me -- I can't
4 predict what will result from this round of
5 proceedings. Some outcomes, three years would make
6 great sense, maybe even longer. Some outcomes might be
7 so plainly temporary that a quicker return would make
8 sense.

9 It really depends on what kind of system is
10 put in place. And I would love to be able to predict
11 that, but I can't.

12 Q When you get to a point where you can, let us
13 know.

14 If the Commission were to continue on its
15 current path of reviewing the new regulatory framework,
16 for instance, every three years, would it be helpful to
17 have certain benchmarks by which the effectiveness of
18 the framework could be judged?

19 A I am not sure what benchmarks you have in
20 mind. But certainly the review would want to be
21 informed by data from outside California as well as
22 inside California.

23 Q I was thinking of time benchmarks as opposed
24 to specific substantive data availability.

25 A I'm sorry. Then I don't understand the
26 question.

27 Q Let me back up and see if I can re-think it,
28 rephrase it. If the Commission were to continue on its

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1 current path of reviewing the new regulatory framework,
2 for instance, every three years, would it be
3 economically reasonable to set event benchmarks in that
4 interim period by which certain relief from regulation
5 could be granted until the next time the Commission
6 comes back to take a look at the effectiveness of the
7 regime?

8 A It again would depend on the nature of the
9 regime. It might well be sensible to provide for
10 changing the nature of the regime between full formal
11 reviews, say by increasing the extent of price
12 flexibility in certain areas or deregulating certain
13 services. How and to what extent and with what triggers
14 you would want to do that is again a reasonably
15 complicated problem.

16 You want to on the one hand be responsive to
17 changed market conditions and on the other hand not use
18 indicators of those conditions that are susceptible to
19 manipulation by market participants.

20 So it is a difficult design problem. Market
21 share, for instance, often comes up in this context that
22 I find particularly problematic.

23 But that's a broad set of issues we could
24 spend a day on.

25 Q And reasonable people could disagree on what
26 the proper triggers ought to be, could they not?

27 A I expect that's true, yes.

28 Q In looking at page 7 of Attachment 1 to your

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1 testimony, your direct testimony, in the full paragraph
2 that appears at the bottom of that page, just four lines
3 from the bottom is a sentence that begins:

4 "For example, the current price
5 cap rule requires uniform reductions
6 in the real prices (or price
7 ceilings) of all regulated services
8 irrespective of their underlying
9 costs and/or market conditions."

10 Do you see that?

11 A Yes.

12 Q That requirement for uniform reductions is in
13 fact the result of this GDP-PI minus X factor that we
14 have been asked to look at in this proceeding, is it
15 not?

16 A And the Commission's decision not to, say,
17 follow the FCC and have baskets with flexibilities
18 within baskets, yes, that's correct.

19 Q In that situation where uniform reductions in
20 the price ceilings of regulated services takes place,
21 isn't that the situation where the productivity factor
22 exceeds the inflation rate?

23 A That is the circumstance under which real
24 prices fall, that's correct.

25 Q Wouldn't it be conversely true that where the
26 inflation rate exceeds the productivity factor, there
27 will be automatic increases in the price ceilings
28 irrespective of their underlying costs and/or market

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1 conditions?

2 A There would be increases in the nominal price
3 ceilings, that's correct.

4 I think I misspoke a minute ago. The real
5 prices in effect fall by the X factor regardless. It
6 has to do with the issue of whether they rise -- whether
7 nominal prices rise has to do with the rate of
8 inflation. The issue of real prices has to do with the
9 X factor.

10 Q Now, in the situation where the inflation rate
11 is projected to continue at 3 percent and the
12 productivity factor, if the Commission were so inclined,
13 was reduced to 2 percent, would that not create a
14 situation where there would be uniform increases in the
15 nominal prices without regard to underlying costs and/or
16 market conditions?

17 A If inflation grows at 3 percent and the
18 X factor is set at 2 percent, there would be an
19 automatic one percent nominal increase in prices
20 regardless of anything, that's correct.

21 Q Over on page 8, in the middle of that page
22 where you're talking about Professor Kahn's description
23 of how regulation should evolve in the face of growing
24 competition, the first rule, the first simple rule you
25 have here is that efficient entry requires that prices
26 be efficient; i.e., rates be rebalanced to eliminate
27 subsidies and/or competitively neutral universal service
28 funding mechanisms be in place. Do you see that?

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1 A Yes.

2 Q You also recognize in the footnote that the
3 Commission does in fact have a proceeding going on
4 regarding universal service funding, do you not?

5 A Yes.

6 Q When we talk about efficient entry, wouldn't
7 that inherently include any efforts to reduce the
8 barriers to entry?

9 A Well, to be clear, some barriers to entry
10 reflect sort of real economic considerations. In
11 industries with unregulated industries with extensive
12 scale economies, those scale economies serve to prevent
13 entry, but lots of entry would be inefficient.

14 I think one of the issues here and one of the
15 reasons for focusing on the regulatory regime is to
16 eliminate unnecessary -- I guess unnecessary is as good
17 a word as any -- entry barriers. But I don't think in
18 this market or other markets there is much to be gained
19 from trying to force entry or to drive down barriers
20 that arise in the natural course of competitive
21 markets.

22 Q When you talk about markets where there are
23 economies of scale in operation where entry by
24 competitors might be inefficient, isn't the local
25 exchange market one such market?

26 A I didn't say entry by competitors would be
27 inefficient. I said entry by lots of competitors would
28 be inefficient.

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1 I think there are always countervailing
2 issues. The argument that the interLATA market has
3 significant economies of scale is, I think, technically
4 sound, but I think that the benefits of competition
5 outweigh small losses in scale economies. I think that
6 applies to other markets as well.

7 It is a question of is there a policy reason
8 for trying to force entry. And I think the answer is
9 almost generally no.

10 Is there a policy reason for trying to get
11 unnecessary government-created entry barriers out of the
12 way, the answer is quite often yes.

13 Q Is it your opinion that the only unnecessary
14 barriers to entry are government created?

15 A One can have situations in which actions by
16 incumbent sellers retard entry, and that of course is
17 the province of the antitrust laws. And, by and large,
18 cases in which that is significant are relatively rare,
19 but they do exist. And that is one of the purposes of
20 the antitrust laws is to deal with those situations.

21 Q Isn't it also true that that is one way in
22 which this Commission and the FCC ensured the public
23 interest is by guaranteeing that unnecessary barriers
24 that are generated by incumbent service providers are
25 eliminated?

26 A I don't think of this Commission or the FCC
27 being in the business of doing antitrust. I think
28 obviously they have an interest in making sure that

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1 existing providers do not inhibit the move toward
2 effective competition. But beyond that, the division of
3 labor between and among this Commission, the FCC and the
4 antitrust courts is again a design problem that I
5 haven't gotten into in this context.

6 Q Let me direct your attention to
7 Professor Kahn's second simple rule, that open entry
8 demands deregulation of the incumbent services that are
9 no longer monopoly provided.

10 Now in reading that it appears to me to be a
11 chicken and egg situation. Isn't it true that there
12 cannot be -- that if there is no new entry, that the
13 services offered by the incumbent will continue to be
14 monopoly provided?

15 A What is intended here, you are right, it is
16 kind of -- there is a missing assumption. And the
17 missing assumption is that opening entry will produce
18 entry. So that what is going on in that phrase is
19 removal of artificial restrictions -- and here it is
20 intended to mean regulatory restrictions -- removal of
21 artificial restrictions on entry, paren, (assuming that
22 there is the reasonable expectation that entry will
23 occur), close paren, requires deregulation.

24 If I remove restrictions on entry into water
25 supply and I don't expect any new water companies, I
26 wouldn't want to deregulate water supply, just to be
27 clear.

28 Q But that takes us back to the pregnant